IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 1052 111

HARRY F. DOYLE AND LUCY J. DOYLE (Husband and Wife),
Petitioners,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

THOMAS M. WILKINS,
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Washington, D. C.

May, 1940.

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Supreme Court of the United States

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No.

HARRY F. DOYLE AND LUCY J. DOYLE (Husband and Wife), *Petitioners,*

v.

GUY T. HELVERING, Commissioner of Internal Revenue, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Harry F. Doyle and Lucy J. Doyle, husband and wife, by their attorney, Thomas M. Wilkins, Union Trust Building, Washington, D. C., pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above-entitled cause on March 4, 1940, affirming the decision of the United States Board of Tax Appeals.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 27—R. 30) is reported in 39 B. T. A. 940. The opinion of the Circuit Court of Appeals is reported in 110 Fed. (2d) 157. (R. 74 to 7

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on March 21, 1940. Motion for rehearing was denied on March 21, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925. (R (R

QUESTION PRESENTED.

Where a taxpayer on the cash basis, has received part of the sale price for real property, under an executory contract, and where the vendee refused either to accept the deed or pay the balance: is the income of the executory vendor, arising from his retention of the said forfeited payments, "derived" and therefore taxable to him, (1) in the year in which the litigation following the default is terminated or, (2) in the year in which the taxpayer vendors' claim of right to the payments was perfected upon tender of the deed?

STATUTE INVOLVED.

The Statute involved, namely Section 22(a) of the Revenue Act of 1934, is quoted in the Appendix, page 17 of this Petition.

STATEMENT.

On June 10, 1929 petitioners contracted to sell for $185,000, certain improved real estate bought by them in 1903 for $17,000. (R. 42—R. 52) The vendee, the Tishman Realty and Construction Corporation, hereinafter referred to as the Tishman Company, paid petitioners $35,000 in 1929 and in 1930 paid them $25,000 to be applied as part of

the purchase price. (R. 22—R. 53) The parties fixed June 16, 1930 as the closing date for delivery of the deed and payment of the $115,000 balance of the purchase price. (R. 22)

On this latter date, namely June 16, 1930, petitioners made tender of a valid deed to the property in accordance with the terms of the contract, (R. 22) but the vendee refused either to accept the deed or to pay the balance of the purchase price (R. 22—R. 43), served notice upon the petitioners that the deed was defective in seventeen specific respects, all of which, were false, (R. 24—R. 25—R. 43) and endeavored to settle the matter on mutual releases by offering various amounts up to $12,000 in addition to the $60,000 already paid. These offers were rejected. (R. 44)

The petitioners thereupon immediately instructed their attorney to secure specific performance of the contract. (R. 44—R. 48) However, petitioners delayed for nearly twenty months after defendant's default to do or say anything more; there was no offer, no demand, no communication from the date of the default until February 14, 1933 on which day petitioners brought suit for specific performance of the said breached contract in the Supreme Court of the state of New York. (R. 25—R. 49—R. 57)

In answer to petitioners' suit for specific performance, the Tishman Company set up a counterclaim for the recovery of the $60,000 paid to petitioners under the contract. (R. 58 to R. 68)

On April 3, 1934 the Court entered its decree dismissing petitioners' complaint for laches and dismissing the defendant's counterclaim on the merits. (R. 23 to R. 25) The Court held petitioners had without adequate excuse unreasonably delayed the action for specific performance while the market value of the property as shown at the trial had very substantially decreased. (R. 25)

For all the years 1929 and 1934, inclusive, the petitioners' income tax returns were made upon the cash receipts and disbursements basis. (R. 27)

Petitioner herein does not believe the facts concerning the reporting of this profit in 1930 and 1931 to be material, but has set out such facts in full in the margin.[1]

The petitioners did not include any of the amounts received from the Tishman Company in 1929 and 1930 in their joint return for 1934. In his determination of the de-

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[1] For the years 1929 and 1930 petitioners, in admitted good faith, made and tendered to the collector for filing timely income tax returns reflecting the receipt of the amounts of $35,000 and $25,000 in the years 1929 and 1930, respectively, and tendered with the said returns the income tax indicated therein. The petitioner, Harry F. Doyle, fully explained to the deputy collector all of the circumstances affecting the said contract with the Tishman Company, which had transpired as at the time of tendering each such return. The deputy collector of the Internal Revenue, however, refused to accept the returns so prepared, and required petitioners to prepare returns of income excluding the said items of $35,000 and $25,000 from said returns. In accordance with said instructions of the said deputy collector, petitioners filed timely income tax returns for the years 1929 and 1930, excluding the said items of income.

In March, 1932, in the preparation of the 1931 return, the petitioners again made a full disclosure to the same deputy in the collector's office of all of the facts relating to the transaction, including the default of the Tishman Company. The petitioner, Harry F. Doyle, then submitted for filing a return for 1931, including the said items of $35,000 and $25,000, and the deputy again instructed him not to report the income in that year, but to wait for the final outcome of the sale before doing so. He then assisted Mr. Doyle in the preparation of a 1931 return which Mr. Doyle then executed and filed excluding the said payments. (R. 25, R. 26, R. 45 to R. 48)

After the suit for specific performance was terminated in 1934, the petitioners filed, in 1935, amended joint returns for 1929 and 1930, in which they reported in their gross incomes the respective amounts of $35,000 and $25,000 received from the Tishman Company in those years and paid the additional taxes shown to be due by the amended returns, namely $2,140.33 on the amended return for 1929, and $1,668.84 on the amended return for 1930. Later, on November 6, 1935 to protect their interests, petitioners filed claims for the refund of the taxes paid on the amended returns, plus interest. (R. 26) At no time did an agent of the Government ever request of petitioners a waiver of the state of limitations. (R. 46) The record does not show it, but these claims have not yet been acted on.

ficiency for 1934, however, the respondent has included the total of such amounts, namely, $60,000, in petitioners' gross income for that year as "damages" awarded by the court in the action brought by the petitioners for specific performance. (R. 26)

The Commissioner of Internal Revenue determined a deficiency in income against said petitioners in the amount of $12,711.31 for the calendar year of 1934 on the ground that petitioners did not include, but should have included the said $60,000 of forfeited down payments in income for the calendar year 1934. Petitioners duly appealed to the Board of Tax Appeals from the said determination of a deficiency. The Board held as a matter of law that the amounts of $35,000 and $25,000 were taxable income to the petitioners in the year 1934, the year in which the Court dismissed the suit for specific performance and also dismissed the counterclaim of the Tishman Company for repayment to it by petitioners of the $60,000, which it had paid them in 1929 and 1930 (R. 27 to R. 30). United States Circuit Court of Appeals for the Second Circuit affirmed the decision of the Board. (R. 74 to 79)

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

(1) In holding that the amounts of $35,000 and $25,000 received by petitioners in the years 1929 and 1930, respectively, were "derived" in and constitute taxable income for the year 1934, the year in which the Supreme Court of the state of New York, rendered its decision dismissing petitioners' suit for specific performance and dismissing the Tishman Company's suit for recovery of the said $60,000.

(2) In failing to hold that the said $60,000 is taxable income in the year in which the said sum first became petitioners' property under a claim of right.

(3) In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT.

(1) The decision of the Court below is in direct conflict with the decision of the United States Circuit Court of Appeals for the Third Circuit in the case of *Commissioner of Internal Revenue* v. *North Jersey Title Ins. Co.*, 79 Fed (2d) 492 (1935). In that case the taxpayer in 1927 entered into a written contract for the sale of certain improved real property receiving a part of the sale price in 1927, upon the execution of the contract. Later, on October 1, 1927 the taxpayer, in accordance with the agreement, tendered a valid deed to deliver possession of the property, but the purchaser refused either to accept delivery or to pay the balance of the purchase price. The taxpayer thereupon instituted suit for specific performance in the New Jersey Court of Chancery, which Court during the year, 1928, entered a decree for specific performance, interest to run from October 1, 1927. Thereafter in 1928 the purchaser paid the amount of the decree in full. The Commissioner, as in the instant case, ruled that the sale was consummated in 1928, the year in which the Court rendered its judgment terminating the litigation and held that the profit was taxable in that year, (1928). The Board of Tax Appeals, on the contrary, held that the sale was consummated in 1927 and that the profit should be taxed in that year (1927), and that no part of the profit was income in the year in which the litigation was finally terminated. Upon appeal the Circuit Court of Appeals for the Third Circuit affirmed the Board.

(2) The decision of the Circuit Court of Appeals below holds that income received under a claim of right and without restriction as to its disposition, need not be reported for income tax purposes until the year in which litigation affecting the said claim of right is finally terminated. This decision is in conflict, therefore, with the principle established by the decision of this Honorable Court in *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417, 424,

52 S. Ct. 613, 615, 76 L. Ed. 1197, 1200 (1932). In that case the taxpayer in 1916 operated a section of oil land, the legal title to which stood in the name of the Government. Prior to that year the Government had instituted suit also claiming a beneficial ownership and seeking to oust the Company from possession. Early in 1916 the Government secured the appointment of a receiver to operate the property and to hold the net income thereof. The profits in question were paid to the receiver in 1916 as they were earned. In 1917 the District Court dismissed the Government's action and in that year (1917) the receiver paid the earnings to the taxpayer. The Government appealed (without supersedeas) to the Circuit Court of Appeals, which Court affirmed the lower court's decree in 1920. In 1922 further appeal to this Court was dismissed by stipulation.

On the foregoing facts, this Court held that the profits earned in 1916 were not income of the year 1922, the year in which the litigation with the Government was finally terminated. It held that the profits became income of the Company in 1917 when it actually received them under its claim of right, and without restriction as to their disposition, holding that even though the taxpayer may still be held not entitled to retain the money and even though he may still be liable to restore its equivalent, the income is taxable in the earlier year, and not in the year in which the litigation was finally terminated. In the instant case, under fundamentally comparable facts, the Circuit Court of Appeals below, disregarding the well established "claim of right" rule, held that the final termination of litigation had the effect of creating taxable income.

The notion that the conflict between the *North Jersey Title Company* case and the decision of the Court below, may be reconciled on the ground that one taxpayer was on the cash receipts and disbursements basis and the other on the accrual basis is untenable. Where income, which is the subject of litigation, has been both received and accrued

before the termination of the litigation the differences between the cash receipts and disbursements basis and the accrual basis are without material bearing on the question of whether or not the existing litigation has the effect of postponing the duty of reporting the income. This was expressly recognized by this Honorable Court in *North American Oil Consolidated* v. *Burnet, supra,* where it held the rule to be the same either on the cash or the accrual basis saying:

> "Nor is it material for the purposes of this case, whether the Company's return was filed on the cash receipts and disbursements basis, or on the accrual basis."

286 U. S. 417, 423, 52 S. Ct. 614, 615.

See also *Barker* v. *Magruder,* (App. D. C.) 95 Fed. (2d) 122, 124; *Lucas* v. *No. Tex. Lumber Co.,* 281 U. S. 11.

(3) The decision of the Court below is in direct conflict with the decision of the United States Circuit Court of Appeals for the Fifth Circuit in *Baird* v. *United States,* 65 Fed. (2d) 911. (1933) In that case the taxpayer was a member of a partnership which in 1919 contracted to sell an oil lease to one Flannery for $2,500,000. During that year (1919) under the contract Flannery paid the partnership $500,000 in cash and was to make a further cash payment February 8, 1920 of $300,000 and give his notes for the balance of the purchase price at which time the partnership was to deliver to Flannery a warranty deed for the property and to account to him for the oil runs from the date of the contract. The agreement provided for the forfeiture of the $500,000 in case of Flannery's default upon the partnership's giving him fifteen days' written notice declaring the contract forfeited. The partnership kept its books and filed its returns on the cash basis.

Flannery defaulted on February 8, 1920, but the partnership failed to give the fifteen days' notice of forfeiture, did not tender the deed, but continued its possession and opera-

tion treating Flannery as having an equitable interest in the lease. The partnership took no steps to cancel the contract until it brought suit in January 1921 to set it aside. This suit resulted in a judgment annulling the contract, but ordering restitution of $350,000 to Flannery.

The Circuit Court of Appeals, on the authority of *North American Oil Consolidated* v. *Burnet, supra,* affirmed the District Court's holding that the profit arising from the forfeiture was taxable during the year 1920, namely at the moment when the rights of the partnership arose, from Flannery's default, to keep the forfeited payment. This case is almost on all fours with the instant case. In both cases the taxpayers were on the cash basis, there was an executory contract of sale with partial payments (or earnest money) to be applied on the purchase price in a year or years prior to the date set for closing, the default occurred at the closing date, and suit was brought in a still later year affirming the taxpayers' right to keep forfeited down payments.

It was thus established by *Baird* v. *United States* (*supra*), that money received to which a claim of right later arose (disputed or undisputed) was taxable in the year the right to retain it arose by the acts of the parties and that the termination of later litigation concerning the right to retain such receipts or profits did not establish the moment when such amounts became taxable to the recipient. This decision is wholly irreconcilable with the decision of the Circuit Court of Appeals below.

(4) The question herein involved is one of substantial and general importance in the administration of the income tax laws. Circumstances wherein forfeited initial payments, forming part of the purchase price of executory contracts of sale, where the right or inclination to sue for specific performance exists, are, comparatively speaking, of frequent occurrence.

The revenue law involved in the instant case is comparable as regards the issue herein to the later and current revenue laws, therefore, the question herein raised is obviously most likely to recur from time to time under such later laws.

It is important, therefore, that this Honorable Court take jurisdiction of this case by the granting of a writ of certiorari to review the decision of the lower court with the view to correcting the present conflict between the decision of the Circuit Court of Appeals for the Second Circuit below and the above-mentioned decisions of the Circuit Courts of Appeals for the Third and Fifth Circuits as to the effect on the taxable period of the termination of litigation involving forfeited down payments.

In the light of the present conflicting decisions, it is confusing and creates uncertainty, both, to the taxpayer and the Government not to have a clear pronunciation from this Honorable Court as to the year in which such forfeited down payments are "derived" and therefore taxable.

It is important, also, that this Honorable Court make a judicial clarification which will remove the uncertainty that has arisen as a result of the decision of the Circuit Court of Appeals below, as compared with the decision of this Honorable Court in *North American Oil, Consolidated* v. *Burnet* (*supra*), the decisions of the Circuit Courts of Appeals for the Sixth, Seventh, and Tenth Circuits, and the Court of Appeals for the District of Columbia cited on pages 11 and 12, as regards the extent, if any, to which the termination of litigation concerning the right to retain income previously received, affects the taxable period of such income.

Indicative of the uncertainty and confusion existing as to the extent to which the termination of litigation, concerning the right to retain income previously received under a claim of right, affects the taxable period of such income, the attention of this Honorable Court is respectfully invited to the contention now being made by the Com-

missioner of Internal Revenue before the United States Circuit Court of Appeals for the Ninth Circuit in the case of *Commissioner of Internal Revenue* v. *Alamitos Land Company* (No. 9404). In his brief filed with that Court in March, 1940 the Commissioner of Internal Revenue, inconsistently with his position in the instant case, is making the identical argument contended for by the Petitioners herein, that income received by the taxpayer in that case during the years 1932 and 1933 is taxable in such years, notwithstanding the pendency of litigation, under which the taxpayer was required by the Court, in a later year, to repay a fund of more than one-half million dollars of which, upon settlement in 1938, it received back one hundred thousand dollars. The Board of Tax Appeals held (40 B. T. A. 353) that the pendency of the litigation, which was largely successful, gave the taxpayer the right to postpone the reporting of the income until after the litigation was terminated. The case has been argued but the decision of the Circuit Court of Appeals has not yet been rendered.

(5) Also in conflict with the decision of the Court below, the following authorities, including long continued administrative practice, consistently support the rule that the termination of litigation concerning the right to retain income rightfully received in a previous year, does not affect or control the period in which the income is to be taxed: *Commissioner of Internal Revenue* v. *Brooklyn Gas Co.*, 62 Fed. (2d) 505 (1933 C. C. A. 2);[2] *Board* v. *Commissioner*, 51 Fed. (2d) 73, 75 (1931 C. C. A. 6), Cer. Den. 284 U. S., 658, 52 S. Ct. 35;[3] *Barker* v. *Magruder*, 95 Fed. (2d) 122,

[2] Funds impounded pending outcome of rate litigation held taxable in year of withdrawal under bond notwithstanding litigation continued and terminated in a later year.

[3] Corporate stockholder held taxable in 1920 on receipt by him from liquidating trustees of his share of profits from sale notwithstanding that unsuccessful litigation challenging his right to profits was terminated in 1927.

124 (1938 App. D. C.); [4] *Griffin* v. *Smith,* 101 Fed. (2d) 348, 350 (1939 C. C. A. 7), Cer. Den. 308 U. S. 561, 60 S. Ct. 73; [5] See also G. C. M. 16730 XV-1 C. B. 179; [6] G. C. M. 20296, 1938-2 C. B. 198. [7] Ct. D. 499, XI-1 C. B. 293.

In all of the foregoing cases, the right to retain the income existed at the time of its receipt. When, as in the instant case, the circumstance giving rise to the right to retain it as income occurs *after* the receipt of the fund, such circumstance does not serve to make the later termination of litigation, concerning the right to retain it, controlling as to the period in which to tax it. *Baird* v. *United States, supra.*

For other analogous Circuit Court of Appeals or Appeals D. C. decisions reaching a similar conclusion see: *Saunders* v. *Commissioner,* 101 Fed. (2d) 407 (1939 C. C. A. 10th); *Commissioner* v. *Lyon,* 97 Fed. (2d) 70 (1938 C. C. A. 9th); *Fairmont Creamery Corp.* v. *Helvering,* 89 Fed. (2d) 810 (1937 App. D. C.); *Renwick* v. *United States,* 87 Fed. (2d) 123 (1937 C. C. A. 7th); *Umsted* v. *Commissioner,* 72 Fed. (2d) 328 (1934 C. C. A. 8th); *Blum* v. *Helvering,* 74 Fed. (2d) 482 (1934 App. D. C.); *Champlin* v. *Commissioner,* 78 Fed. (2d) 905 (1935 C. C. A. 10th); *Ford* v. *Commissioner,* 51 Fed. (2d) 206 (1931 C. C. A. 6th); *Victoria Paper Mills Co.* v. *Commissioner,* 32 B. T. A. 666, affirmed without opinion, 83 Fed. (2d) 1022 (1936 C. C. A. 2d).

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[4] Uncollected usurious interest accrued on books of taxpayer before receivership held taxable when accrued notwithstanding fact that its collection was not legally enforceable.

[5] Corporate officer held taxable on bonus year of receipt notwithstanding subsequent court decision holding payment "void" and requiring repayment to corporation.

[6] Corporate director on cash basis held taxable in year of receipt of profits from stock transactions, although he was required by a judgment in a later year to surrender the profits to stockholders of his corporation.

[7] Fees of Executors on cash basis held taxable in year of receipt rather than later when approved by court.

(6) The decision of the Court below was predicated, in effect, upon the premise that the judicial determination in 1934 of the action brought in the Supreme Court of the state of New York by the taxpayer herein, put an end to or destroyed *rights* which the petitioners had *before* the suit for specific performance was brought. Such a premise seems to proceed on the notion that the jurisdiction of a Court in such a proceeding is not merely to hear and determine the rights of the parties, but to hear and *create rights* which were previously nonexistent, and to *put an end to rights* which previously existed.

We do not believe that parties emerge from litigation with *rights* different from those which they possessed when the litigation commenced. While the judgment of a Court puts an end to the *controversy* between the parties, it does not put an end to any one's *rights.* It does not fix the rights of either party any differently than as they existed when the suit was brought.

In exercising its jurisdiction in the proceeding between petitioners and the Tishman Company, the Court was exercising normal judicial functions. Courts do not make the law, change the law, make the facts, change the facts, or change the rights of the litigants in exercise of their judicial power. As stated by this Honorable Court in *Prentis* v. *Atlantic Coast Line Co.*, 211 U. S. 210, 29 S. Ct. 67, 69:

> "A judicial inquiry investigates, declares, and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. That is its purpose and end. Legislation, on the other hand, looks to the future and changes existing conditions by making a new rule, to be applied thereafter to all or some part of those subject to its power."

As stated by Justice Field in his dissenting opinion in the *Sinking Fund* cases, 99 U. S. 700, 761:

> "The distinction between a judicial and legislative Act is well defined. The one determines what the law

is, and what the rights of parties are, with reference to transactions already had; the other prescribes what the law shall be in future cases arising under it. Whereever an Act undertakes to determine a question of right or obligation, or of property, as the foundation upon which it proceeds, such Act is, to that extent a judicial one, and not the proper exercise of legislative functions."

See Willoughby on the Constitution of the United States, Volume 3, page 1620.

See also Cooley, Const. Lim. 108:

> "That which distinguishes a judicial from a legislative act is that the one is a determination of what the existing law is, in relation to some existing thing already done or happened, while the other is a predetermination of what the law shall be for the regulation of future cases falling under its provisions."

The function of the Supreme Court in the state of New York in deciding *Doyle* v. *Tishman* in 1934 was judicial and not legislative. Therefore, it created no new rights, but merely recited the rights of the parties, as they existed when they came before the Court, and promulgated an order protecting those pre-existing rights. In this, the Court exercised a judicial function. The Court did not put an end to petitioners' right to specific performance. The power to do that would be a legislative or even a constitutional power, which the Court never had, and never attempted to exercise. Therefore, no income was "derived" by petitioners in 1934 when the Court's decision was handed down. Quite on the contrary, income is "derived" when rights accrue as the result of the *acts of the parties,* and not in a later year when a court judicially determines what those rights so previously created by them were. (Sec. 22(a), Act of 1934)

If judicial determinations had the effect of creating new and different rights, the case of *Virginia Iron Coal & Coke Co.* v. *Commissioner,* 99 Fed. (2d) 919 (1938 C. C. A. 4) might be analogous as suggested by the Court below. In

that case the taxpayer received moneys in 1930 and 1931 in consideration of granting an option on real estate owned by it. Under the option, when exercised, the moneys were to be applied against the purchase price, but the parties terminated the option by special agreement between them in 1933 under which the taxpayer kept the money previously received. The Court held the payments to be income in 1933. There the parties themselves created the new rights in 1933, giving rise to income in that year. There was no litigation, as there was in the instant case. If there had been, the ultimate Court decision would not have *created* income, it merely would have defined the rights of the parties on the basis of their past acts, which past acts would have given rise to the income at some critical point wholly without reference to the termination of the litigation. In the *Virginia* case such critical point probably would have been in 1933 when the option holder affirmatively elected to abandon the option. This critical point would not be postponed by a Court decision rendered to that effect in 1934 or some later year.

(7) In the interest of protecting the revenue, it has long been established that deductions from income will not be allowed with respect to the obligation to pay expenses or other deductible amounts, while the obligation itself remains contingent by reason of the pendency of litigation or by any other contingent circumstance. *Brown* v. *Commissioner,* 63 Fed. (2d) 66, 68, G. C. M. 20296, 1938-2 C. B., 198, 201. On the other hand, but still consistent with the purpose of protecting the revenue, the effect of litigation on the right to *retain income already rightfully received,* has never before been permitted by any appellate court to postpone the taxation of the income pending the termination of the litigation. In fact this rule has been so rigidly adhered to that even when a taxpayer has had to surrender previously taxed income pursuant to a final court decision depriving him of it, his claim for the refund of the tax on its original receipt was rejected, on the ground that the amount

was originally received under a claim of right. *Griffin* v. *Smith, supra.*

The effect of the existence of litigation with respect to *deductible items* and with respect to *items* of *income* already received under a claim of right, creates problems calling for some solution in common. The policy of protecting the revenue, which *postpones the deductibility of expenses,* and *accelerates the taxability of income* in the face of active litigation, furnishes a consistent solution to both problems, *North American Oil Consolidated* v. *Burnet, supra.* Viewed in this light, these two otherwise seemingly inconsistent principles can be reconciled. See *Lucas* v. *American Code Co., Inc.,* 280 U. S. 445, 50 S. Ct. 202, where a reserve contingent on the outcome of litigation was disallowed as a deduction.

This Honorable Court is urged, however, not to ignore the significant fact that the income tax rates in effect during the years in which the income in question was both received and earned (1929, 1930, and 1931) were approximately only half of what such rates on the same amount of income were in the year in which the litigation terminated (1934), and that the income in question was not "derived" during the year 1934.

CONCLUSION.

For the foregoing reasons it is respectfully submitted that the $60,000 in issue was not "derived" in 1934 by these taxpayers in any sense of the word as used in Section 22(a) of the Revenue Act of 1934, and that this petition should, therefore, be granted.

Respectfully submitted,

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May, 1940.

APPENDIX.

Statutes Involved.

Excerpts from the Revenue Act of 1934.

Sec. 22. Gross Income. (48 Stat. 686.)

(a) General definition.—"Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * * .

Sec. 41. General Rule. (48 Stat. 694.)

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see Section 22(c).)

Sec. 42. Period in Which Items of Gross Income Included. (48 Stat. 694.)

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which fall the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period.

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On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

PETITIONERS' REPLY BRIEF TO RESPONDENT'S BRIEF IN OPPOSITION.

1. The Respondent's brief, in opposition, proceeds on the erroneous theory that income is taxable in the year in which some court may classify it, or determine its status, and not in the year in which it was actually "derived." The Act taxes income when it is "derived." Neither the language of the Act nor its spirit justifies the attempt to tax in a later year "income derived" in an earlier year, merely because some court may judicially announce the "classification or status" of the income in the later year. The statute would have to be worded differently to permit the postponement by litigation or anticipated litigation,

of taxation of income previously "derived" as contended for by the respondent.

When would it be proper to tax this income if Petitioners' suit had never been brought?

2. We insist vigorously and with sincere confidence that there is definitely a *bona fide* conflict between the decision below and the decision of the United States Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *North Jersey Title Ins. Co.*, 79 Fed. (2d) 492.

We insist that what is important as to the existence of a conflict here, is that litigation, which determined the "classification or status of the cash payment" was involved in both cases. In one case litigation was held to postpone taxability, and in the other it was held exactly the opposite.

Respondent's conclusion that there is no conflict is predicated on fallacious reasoning and an obvious misconception of what was involved in the *North Jersey* case. Respondent says (Res. Br. 6):

> "That case did not involve the question, here presented, as to the effect of a subsequent judicial determination, which for the first time converts into profit what had previously been a return of capital."

In both cases a cash down payment had been made and suit for specific performance followed. In both cases, it was not known until the litigation terminated whether *all* of the cash payment would be regarded as *income* or a *part* would be regarded as *return of capital.* We do not believe that the Court decision in either case "converts into" one thing something which had previously been "something else." But we insist that if litigation in the one case leaves income or capital to be converted into capital or income by the Court, the same is true in both cases.

We most vigorously insist also that the *North Jersey* case *did* involve "the precise question here presented, as to the effect of a subsequent judicial determination, which for the first time" decided what portion of the down payment was profit and what portion of it was return of capital. In both cases the "classification or status of the cash payment" was not determined *judicially* until the Court rendered its decision. The status of the fund would be equally uncertain and the Court's decision would have had the same effect in both cases as to the part of the down payment which could be "converted into" profit or return of capital, either under the cash basis or under the accrual basis. In none of these cases referred to in the petition does this difference in accounting methods become material. See *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417, 423, 52 S. Ct. 614, 615.

Respondent has offered no reason whatsoever as to why these methods of accounting should be a material factor here. It must be assumed therefore that there are no such reasons applicable here, otherwise Respondent would have attempted some answer to Petitioners' contrary arguments. (See Petition, bottom p. 7 and top of p. 8).

To say (Res. Br. 7), that the Court in the *North Jersey* case was not concerned with "the classification or status of the cash payment" merely avoids the true issue. In that case, as in the instant case, the cash payment contained a portion of capital and a portion of profit, and should specific performance have not been decreed, as in the instant case, all the cash payment and no more would have been income. If specific performance were to be decreed, in both cases the cash payment would be "converted" into return of capital in part and part would remain profit. In *both cases,* until the Court rendered its decision, it was not known what part of the cash payment would be profit and what part would be return of capital.

Clearly, in both cases, whether the Court decreed specific performance or forfeiture, the "classification or status of the cash payment" as income or capital was not determined until its decision was rendered.

If, as contended by the Respondent, the income is taxable in the year in which the "classification or status of the cash payment" is determined by a Court decision, Respondent's statement (Res. Br. 7) that "in the *North Jersey* case the Court was not concerned with the classification or status of the cash payment" is inaccurate and untrue. The conflict is clear.

Respondent's denial of conflict between the decision below and the decision of the United States Circuit Court of Appeals for the Fifth Circuit, in *Baird* v. *United States,* 65 Fed. (2d) 911, is entitled to no weight because it is predicated on a misstatement of fact indispensable to Respondent's tenuous ground of distinction. Respondent states (Res. Br. 8) as to the *Baird* case:

> "The Court there recognized that the payment could not be classified as income in the year in which it was actually received (1919) but decided that upon the facts presented, the status became fixed in the succeeding year (1920) when, following the default, *the seller elected to declare the payment forfeited."* (Italics ours.)

The truth which Respondent misstated is that, in the *Baird* case, the seller *did not* elect to declare the payment forfeited until *in 1921* when the suit was brought, which, in that case resulted in annulling the contract. The truth is also that under the agreement in the *Baird* case, the seller had only fifteen days from the date of default (February 8, 1920) within which, by written notice, he was required to exercise his *election* to declare the contract forfeited. (See pages 8 and 9 of Petition.) This

he actually failed to do and the suit he eventually brought in 1921, later determined that only $150,000.00 of the $500,000.00 received by him in 1919 could be retained by him. In the *Baird* case, *supra,* the Circuit Court of Appeals held the seller's income taxable in 1920, not, as Respondent states, because it was *then* (1920) that "the seller elected to declare the payment forfeited," *which is exactly what he did not do then,* but in truth because on February 8th, 1920, the seller's rights arose to keep $150,000.00 of the payment as the result of Flannery's failure to go through with the contract which the seller was ready to perform. The Seller's election in the *Baird* case, as in the instant case, did not occur *until suit was brought.* However, the Court in the *Baird* case ignored such time of election in 1921 and held the income was derived in 1920, the year of default. The Circuit Court affirmed the District Court's specific holding that the "choice" of the seller "was not exercised until January, 1921, when he determined to disregard that option and sued for the dissolution of the contract * * *." (3 Fed. Supp. 947, 949). The conflict here is clear also.

Respondent's denial of conflict (Res. Br. 8) between the decision below and that of this Honorable Court in *North American Oil Consolidated* v. *Burnet,* 286 U. S. 417, completely disregards the fundamental principle and raises "a distinction without a difference." The question there, as here, was as to the effect of *litigation* on *income* already "derived" and received. The fact that the income there was merely called "earnings" and that here the income is called "profits" is Respondent's only excuse for distinguishing the cases. Obviously, both "earnings" and "profits" are "income" and the distinction seems wholly irrelevant and pointless. No reason for this supposed distinction is offered. However, some of the "other decisions" cited in the Petition (Pet. 11, 12) referred to by Respondent (Res. Br. p. 8) as being "similarly distinguishable" involve "profits" from sales rather than

"earnings." See for example *Board* v. *Commissioner*, 51 Fed. (2d) 73, 75 (1931 C. C. A. 6), Cer. Den. 284, U. S. 658, 52 S. Ct. 35; G. C. M. 16730 XV—1 C. B. 179; *Baird* v. *United States*, 65 Fed. (2d) 911; and in *Blum* v. *Helvering*, 74 Fed. (2d) 482 (1934), the Court of Appeals for the D. C. in paraphrasing the words of this Honorable Court in *North American Oil Consolidated* v. *Barnet*, *supra*, actually substituted the word "*profits*" for the word "*earnings*" to make the question apply to the situation there, clearly recognizing that the principle is fundamental and applies whether earnings or profits are involved. The case of *Commissioner* v. *North Jersey Title Ins. Co., supra*, also involved "profits" as distinguished from "earnings."

The Respondent does not deny Petitioners assertion (Pet. 9, 10) that the question herein involved is one of substantial and general importance in the administration of the income tax laws. Nor does the Respondent deny the existence of uncertainty and confusion as to the extent to which the termination of litigation affects the taxability of income already received and held under claim of right. This seems tantamount to an admission of the general importance of the fundamental question herein involved and of the uncertainty and confusion existing in this regard and justifies the granting of Certiorari by this Honorable Court.

No attempt has been made by Respondent to answer Petitioner's argument (Pet. 13 to 15) that income is not derived or created by Court decisions.

It is earnestly prayed, therefore, that the Writ of Certiorari be granted.

Respectfully submitted,

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Attorney for Petitioners,
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Washington, D. C.

June 29, 1940.

INDEX

CITATIONS

238922—40

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 111

HARRY F. DOYLE AND LUCY J. DOYLE (HUSBAND AND WIFE), PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 20–30) is reported in 39 B. T. A. 940. The opinion of the Circuit Court of Appeals (R. 74–77) is reported in 110 F. (2d) 157.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 21, 1940 (R. 78). A petition for rehearing was denied on March 21, 1940 (R. 78).

The petition for writ of certiorari was filed May 28, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Petitioners in 1929 contracted to sell certain real estate for $185,000. The vendee paid $35,000 in 1929 and $25,000 in 1930. In 1931 the vendee defaulted on the contract, refusing to make further payment. A suit for specific performance instituted by petitioners resulted in a decision in 1934 that petitioners were not entitled to specific performance but that they need not restore the payments received from the vendee in 1929 and 1930.

The question presented is whether petitioners realized taxable income in 1934 in the amount of these payments.

STATUTE INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or

the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (U. S. C., Title 26, Sec. 22).

STATEMENT

The petitioners, husband and wife, purchased a house in New York City in 1903 for $17,000, with title taken in the name of the wife. The value on March 1, 1913, was claimed by the petitioners to be $90,000. This was controverted by the Commissioner, and no value as of that date was proved (R. 21, 30).

In 1929 the wife made a contract to sell the house to Tishman Realty and Construction Company for $185,000. Of the purchase price, $35,000 was paid at the signing of the contract in 1929; $10,000 was to be paid by the purchaser by assuming a mortgage in that amount against the premises; the balance, $140,000, was to be paid upon delivery of deed at the date set for closing, June 10, 1930. The contract provided that the purchaser might have an extension of the closing date to June 10, 1931, on payment of a further sum of $25,000 on or before June 10, 1930. The petitioners remained in possession of the property. In June 1930 the Tishman Company availed itself of the right to the extension and paid the agreed $25,000 (R. 21–22).

On the day fixed for closing, in June 1931, the petitioners tendered a proper deed and demanded

payment of the balance of the purchase price, $115,000. The Tishman Company pretended that the title was defective and refused to go through with the sale. The petitioners directed their lawyer to bring suit for specific performance. The lawyer delayed in the hope of a settlement, but finally, in February 1933, brought suit for specific performance, demanding that the Tishman Company be compelled to pay the $115,000 balance against delivery of deed. The Tishman Company defended on the merits and made counterclaim for the $60,000 that had been paid. The case was tried and, in 1934, the court dismissed both the complaint and the counterclaim. The court held that the purchaser's objections to the title were pretences made in an effort to get out of a bad bargain, but denied specific performance because of the delay in commencing suit (R. 22–25, 29).

Accordingly the petitioners were left with the real estate and the $60,000 received on account of the purchase price. The Commissioner took the view that the $60,000 was income for 1934, and determined a tax deficiency for 1934. The petitioners asserted that the $60,000 was income in prior years (R. 25, 26, 27). During the years 1929–1934, inclusive, petitioners' income-tax returns were made upon a cash-receipts-and-disbursements basis (R. 27).

The Board of Tax Appeals approved the determination of the Commissioner (R. 30), and the court below affirmed (R. 77).

ARGUMENT

1. In 1929 and 1930, when the controverted payments were received, and in 1931, when the breach occurred, it was impossible to classify them properly for tax purposes. On the theory that they represented advance payments of the purchase price, no tax would be due until the sale was consummated and an amount was received by the vendors in excess of their capital investment or statutory basis. If the contemplated sale resulted in a profit, such profit would be taxable only when and to the extent that the payments received exceeded the basis of the property sold. *Burnet* v. *Logan,* 283 U. S. 404. If, however, the vendee wrongfully refused to close the deal, the vendors might become entitled to the payments made without any offsetting loss of capital assets, in which event the payments would be taxable as income in their entirety. But, until the sale was consummated, or in case of breach until the rights of the parties were established, it could not be determined into what category the payments would fall.

It is the position of the Government, sustained by the findings of the Board of Tax Appeals and approved by the court below, that the true status of the payments could not be determined until 1934. They could not be taxed as income in the years of actual receipt, 1929 to 1930, for they were then being held as part of the purchase price of a capital asset, the basis of which (presumably March 1,

1913, value in this case) the vendors were entitled to receive in full before subjection to tax. They could not be taxed in 1931, the year of the asserted breach by the vendee, because the vendors did not then elect to declare the contract forfeited, as they might have done. Instead, the vendors insisted on closing the deal and subsequently filed suit for specific performance, which terminated in 1934. It was then for the first time possible to determine the status of the payments. Cf. *Virginia Iron, Coal & Coke Co.* v. *Commissioner,* 99 F. (2d) 919 (C. C. A. 4th), certiorari denied, 307 U. S. 630.

2. As a primary reason for granting the writ, the petitioners assert (Pet. 6) a direct conflict with *Commissioner* v. *North Jersey T. Ins. Co.,* 79 F. (2d) 492 (C. C. A. 3d). There the taxpayer contracted in 1927 to sell certain property and received a down payment upon entering into the contract. In 1928 a court decreed specific performance and the balance of the purchase price was paid by the vendee in that year. The taxpayer was on the accrual basis of accounting, and the question presented was whether the profit realized upon the sale should be ascribed to the year 1927 or to the year 1928. That case did not involve the question, here presented, as to the effect of a subsequent judicial determination which for the first time converts into profit what had previously been merely a return of capital. That case turned primarily upon the Board's finding of fact that the contract, from the

taxpayer's point of view, was fully executed in 1927, and that the liability of the purchaser was then unconditional. Since the taxpayer was on the accrual basis, the profit to be derived from this unconditional liability became accrued income in that year. The taxpayers in the case at bar were on the cash receipts and disbursements basis, and this factor alone is sufficient to distinguish the cases. In the *North Jersey* case the court was not concerned with the classification or status of the cash payment. The entire purchase price became accrued income in 1927, and the margin of profit to be taxed as income could therefore be determined at that time.

The further contention (Pet. 8) that the decision of the court below is in direct conflict with *Baird* v. *United States,* 65 F. (2d) 911 (C. C. A. 5th), certiorari denied, 290 U. S. 690, is likewise unfounded. There, as here, a large cash payment had been made at the time the sales contract had been signed in 1919. On the failure of the purchaser to pay an additional sum called for in the succeeding year, the seller had the right to claim the down payment forfeited. The court concluded that since the seller had, in January 1921 (before the filing of his income-tax return for 1920), instituted a suit for the cancellation of the contract because of the failure to pay the additional sum, the payment received in the prior year (1919) thereupon assumed the status of income for the succeed-

ing year (1920). The court there recognized that the payment could not be classified as income in the year in which it was actually received but decided that upon the facts presented, the status became fixed in the succeeding year when, following the default, the seller elected to declare the payment forfeited. It is to be noted that, in the case at bar, the court conceded that (R. 76) if the petitioners had elected to exercise their legal right to treat the transaction as ended, the status of the payments as income might have been fixed in 1931. However, under the findings of fact by the Board (R. 21–27), such was not the case here.

Petitioners also assert (Pet. 6–7) that the decision below is in conflict with *North American Oil* v. *Burnet,* 286 U. S. 417. That case, however, involved *earnings* that were received during the taxable year and were subject to the unrestricted use of the taxpayer. The Court simply held that the mere fact that there was outstanding a claim of right to those earnings in a third person did not deprive them of their quality as earnings when received. Here, on the other hand, the down payments constituted merely a return of capital until their status was otherwise determined in 1934. The other decisions likewise asserted to be in conflict with the decision below (Pet. 11–12) are similarly distinguishable.

CONCLUSION

There is no conflict of decisions, and the decision below is correct. The petition should be denied.

Respectfully submitted.

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